Jens Weidmann: Dinner speech

Dinner speech by Dr Jens Weidmann, President of the Deutsche Bundesbank and Chairman of the Board of Directors of the Bank for International Settlements, at the "350 years of Central Banking: The Past, the Present and the Future" a Sveriges Riksbank anniversary conference sponsored by the Riksbank and the Riksdag, Stockholm, 25 May 2018.

* * *

1 Introduction

Your Royal Majesties

Mister Speaker Ahlin

Chairperson Eberstein

Governor Ingves, dear Stefan

Your Excellencies

Honourable guests

Dear colleagues

Thank you for inviting me to speak to such a distinguished audience at this extraordinary event. It is a truly remarkable anniversary we are celebrating today. I, too, want to congratulate Stefan Ingves and all of the Riksbank staff on 350 years of central bank history. This is an amazing achievement.

Being the world's oldest central bank, and the third-oldest bank, it has been a trailblazer for monetary institutions from the get-go. When we talk about the history of the Riksbank, we talk about the history of central banking and money itself. And I would like to share some thoughts on these two histories while I make you wait for the dessert.

The Austrian playwright Johann Nepomuk Nestroy once remarked: “The Phoenicians invented money. But why so little of it?”

The question may sound unserious today. But the answer that presumably pops up immediately in everyone's head – to be of value, money has to be scarce – is there because history has drummed it in over and over again, with some of the earliest chapters coming from the history of the Riksbank.

In 1624, Sweden introduced the copper standard due to a shortage of silver and gold. The new commodity money soon proved rather impractical, though, with the largest copper coins weighing more than 20 kilograms.

In 1660, the central government started to mint new coins of a lower weight. But depositors called for the old, heavier coins, as they had a higher metal value. As customers frantically tried to get hold of the heavier coins, a bank run ensued.

The Riksbank's predecessor, Stockholms Banco, then issued deposit certificates, which were in fact handed out as loans from the bank and could be exchanged for any purchase at will. This marked the introduction of banknotes in Europe.

The banknotes proved initially a huge success, as they were obviously far more convenient than the large and heavy copper coins. But with demand for the new banknotes rising, the bank started to print more and more of them. Soon, the inevitable happened: The notes lost value, the public demanded that their notes be redeemed, and the bank came crashing down.

From the dust of Stockholms Banco, the Riksbank was founded by the government. And one of its tasks was to "maintain the domestic coinage at its right and fair value"[1] – which, neglecting the old-fashioned language, sounds like a policy objective that would still be useful today.

Money based on public trust can powerfully enhance welfare. This is what the experience of the Riksbank has shown, throughout its trials and tribulations. But its experience has also shown that the benefits only accrue if the public's trust in the value of the currency is given policy priority.

2 The Riksbank and inflation targeting

Some of the challenges the Riksbank has encountered during its history have been mentioned already. Let me fast-forward to one of the more recent policies that has certainly strengthened trust in the central bank's ability to deliver price stability: inflation targeting. The Riksbank has been an early adopter of this policy, introducing a target of 2% inflation in 1993.

Inflation targeting greatly helped to moderate swings in inflation and output. In fact, it did so to such a degree that economists like Nobel Prize winner Robert Lucas[2] had declared the central problem of preventing large economic fluctuations to have been solved.

As we now know, inflation targeting has not spelled "The End of History" for monetary policy. Rather, the "Great Moderation", as these years of extreme economic stability came to be known, ended in the "Great Recession".

3 Leaning against the wind

As policymakers had to deal with tumbling banking systems and toxic assets in banks' balance sheets during the financial crisis, they could once again turn to the Nordic experience, this time that of the early nineties.

In a 1996 issue of the Riksbank's Quarterly Review, a certain Stefan Ingves laid out the management of this episode in detail. Later, as the Chairman of the Basel Committee on Banking Supervision, Stefan would put his knowledge to excellent use and made an invaluable contribution to sounder banking systems.

The repercussions of the financial crisis were not limited to regulatory policy, though.

The crisis has reignited the debate of whether central banks should "lean against the wind" and use monetary policy also to prevent the build-up of asset price bubbles. This debate is still ongoing. And as usual, the Riksbank has been at the forefront of it, with regard to both policy invention and implementation.

The Riksbank started to tighten monetary policy in 2010. Initially, the concern was rising consumer prices. But attention soon shifted to high levels of household debt, which were perceived to present a vulnerability to the wider economy. To mitigate this weakness, monetary policy continued to tighten.

This decision was not uncontroversial at the time. Then Deputy Governor Svensson argued that it was the job of macroprudential policy, not monetary policy, to deal with debt vulnerabilities. He voiced his concern that monetary policy was too blunt a tool for mitigating financial stability risks, and that doing so would cause macroeconomic performance to suffer.

And indeed: while household debt was not curbed significantly, inflation dropped below target levels and unemployment started to rise.

What is the takeaway here? For me, it is first and foremost that moving monetary policy into uncharted territory will trigger debate. In my opinion, this is something not to shy away from, but to welcome and embrace. For it is only when we openly and constructively debate our differences that progress is possible.

This episode thus speaks to the strength of the Riksbank as an institution. When it comes to wider implications for monetary policy, it seems to me that the lessons are actually less clear than what immediately meets the eye.

Yes: When it comes to handling financial stability risks, monetary policy is a sledgehammer rather than a scalpel. Macroprudential policy should be the preferred choice of tool, and getting it ready for use has to be a political top priority.

However, the effectiveness of many instruments has not been confirmed in practice. And since applying these instruments could mean, for example, that it becomes harder for some to qualify for a mortgage, policymakers might be reluctant to use them.

In order for monetary policy to fulfil its mandate and to ensure clear accountability, it's important that price stability remains the primary objective of monetary policy.

But that is not to say that when it comes to monetary policy and price stability there are no lessons to be learned. As we have recently witnessed, financial crises have a considerable impact on the monetary policy transmission process, and monetary policymakers' ability to guarantee price stability and price developments as such.

Financial crises almost always originate in excessively loose bank lending.[3] The last crisis was no exception.

Confining monetary policy to mopping up when the milk is already spilled creates an asymmetry. In my opinion, a symmetrical monetary policy that takes into account money and credit growth and that is oriented towards the medium term seems most conducive to price stability.

Just to be clear: I am not arguing in favour of a monetary policy that strictly targets money growth. But I do suggest that money and credit developments provide valuable information to monetary policymakers. In principle, this is already the basis of the Eurosystem's two-pillar strategy.

4 E-krona

Finally, a project where the Riksbank seems to be even more ahead of the pack is digital central bank money. Developments in this field have been dizzying.

We have had to familiarise ourselves with new concepts, including at least the basic intuition of the blockchain, and, not to forget, a host of buzzwords. And whereas minting coins in the 17th century required quite a bit of metal, as I pointed out at the beginning, mining crypto token can require quite a bit of energy — a single bitcoin transaction, for example, uses up to 900 kilowatt hours of electricity (in April 2018), enough to power a four-person household for two months. Separating hidden potentials of new technologies from the hype and excesses is challenging, often arduous.

The effects of digital central bank money on the payment system will not be the only consideration for central banks, however. Depending on its concrete design, digital central bank money would provide non-financial corporations and even households with access to the central bank balance sheet. Evidently, cash allows this, too. But unlike cash, digital balances have no noteworthy storage costs.

Allowing the public to hold claims on the central bank might make their liquid assets safer, because a central bank cannot become insolvent. This is a feature which will become relevant especially in times of crisis – when there will be a strong incentive for money holders to switch bank deposits into the official digital currency simply at the push of a button.

But what might be a boon for savers in search of safety might be a bane for banks, as this makes a bank run potentially even easier. In taking deposits away from banks, it also reduces their ability to engage in maturity and liquidity transformation and make loans.

A new technology therefore reopens an old debate in economics: does maturity transformation enhance welfare, or should banks be prevented from creating liquidity? Once again, the Riksbank is spearheading the debate. And, I am sure, we will all be richer for it.

5 Conclusion

Ladies and gentlemen

I'll leave it at that, as we are now looking forward to the last course, the dessert – and maybe even a piece of the by now famous birthday cake.

Some of you may have seen the video clip — after Stefan has been tasked by the Board with organizing the cake, he bargains with the cake shop over the lettering. And as each letter costs extra, the thrifty Governor has the text cut down from "Sveriges Riksbank 350 years" to "Riksbank 350". While this is certainly meant to illustrate the Riksbank's responsible use of public money, the underlying self-irony also gives testament to the Riksbank's vitality and youthfulness, even at 350 years.

The aforementioned Johann Nepomuk Nestroy also said the following: "Everybody wants to live long, but nobody wants to get old." In my opinion, this sums up the Riksbank perfectly. It has lived for 350 years, and it is going as strong and innovative as ever.

So, to the next 350 years!

---

[1] Gunnar Wetterberg (2009), "Money and Power, From Stockholm's Banco 1656 to Sveriges Riksbank Today"

[2] Robert Lucas (2003), Macroeconomic priorities, American Economic Review, 2003, Vol 93, issue 1, 1-14.

[3] Schularick, Moritz, and Alan M Taylor. 2012. "Credit booms gone bust: monetary policy, leverage cycles, and financial crises, 1870-2008." American Economic Review, 102(2): 1029-61.